



AUDITOR - GENERAL
SOUTH AFRICA

The Accounting officer
Sakhisizwe Municipality
PO Box 21
Elliot
5460

30 November 2009

Reference: 03564REG08/09

Dear Sir


Report of the Auditor-General on the financial statements and performance information of Sakhisizwe Municipality for the year ended 30 June 2009

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act, 2004 (Act No. 25 of 2004) read in conjunction with section 188 of the Constitution of the Republic of South Africa, 1996 and section 121(3) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA).
2. The audit report is issued as a final draft pending our receipt of all other documents that will be included in the annual report that will contain the audited financial statements is received.
3. Once these documents are received we will read them to establish if there are any inconsistencies with the audited financial statements. You will then be requested to amend the other information or the financial statements in respect of any inconsistencies. Once this process has been satisfactorily completed we will issue the final signed audit report.
4. In terms of section 121(3) of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
5. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.
6. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.

- The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.
7. Please notify the undersigned Senior Manager well in advance of the date on which the annual report containing this audit report, will be tabled.
 8. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely


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Ralph Sheffield-Webb

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AUDITOR - GENERAL
SOUTH AFRICA

REPORT OF THE AUDITOR-GENERAL TO PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF SAKHISIZWE MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements and financial statements of the municipality which comprise the statement of financial position as at 30 June 2009, the statement of financial performance, the statement of changes in net assets and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages [xx] to [xx].

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the applicable financial reporting framework and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), *Auditor-General audit circular 1 of 2007* and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3)(d) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
4. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the [name of entity] in this respect will be limited to reporting on non-compliance with this disclosure requirement.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for disclaimer of opinion

Cash and cash equivalents

6. Cash and cash equivalent of R18.3 million is reflected in note 21 to the annual financial statements. Independent confirmations and supporting schedules provided by the municipality did not provide explanations for the unreconciled differences of R550 000. Due to the lack of documentation it was not possible, even through alternative procedures, to obtain sufficient evidence to confirm the cash and cash equivalents balance in note 21 of the annual financial statements.

Trade and other receivables

7. Trade and other receivable of R18.2 million is reflected in note 7 to the annual financial statements. Reliable and complete billing information or customer contact information was not provided by the municipality. Furthermore, journals relating to receivables to the value of R40.9 million were processed without adequate supporting documentation. As a result of the above it was not possible, even through alternative procedures, to obtain sufficient evidence to confirm that the recorded receivables were due to the municipality, all receivables due to the municipality were recorded, in the correct accounts and at the correct amounts and the municipality has the right to collect the amounts outstanding.
8. A provision for doubtful debts of R13.7 million is disclosed in note 9 to the annual financial statements. Documentation in support of the calculation and implementation of this provision could not be provided and no alternative procedures were possible. Furthermore, no consideration was given to the GRAP requirements in raising this provision.

Value added tax (VAT)

9. A VAT receivable of R1.5 million is reflected in note 7 to the annual financial statements. The municipality was unable to provide schedules, calculations and supporting documentation to support this disclosure. Supporting documentation was also not provided for journal entries totalling R8 million processed to the relevant VAT general ledger accounts. Consequently it was not possible, even through the use of alternative procedures, to confirm the accuracy and completeness of the amount disclosed in note 7 of the annual financial statements.

Property, plant and equipment (PPE)

10. Property, plant and equipment of R51.5 million is disclosed in note 8 to the annual financial statements. Included in this amount is land and buildings of R3.5 million. Several items that were included as land and building should have been disclosed as investment property in terms of GRAP 16. Journals to the value of R14.7 million that were processed did not have adequate supporting documentation. I was unable to confirm, even through alternative procedures, that property, plant and equipment

disclosed in note 8 to the annual financial statements was all disclosed and that it was disclosed at the correct value.

Trade payables

11. Trade payables of R407 000 is included in note 3 to the annual financial statements. Documentation could not be provided to support the write-off of creditors totalling R1.9 million. Furthermore, journals to the value of R3 million were processed without adequate supporting documentation. Consequently, it was not possible, even through the use of alternative procedures, to confirm that all trade payables at year end are disclosed in note 3 to the annual financial statements and such payables are disclosed at the correct value.

Consumer deposits

12. The municipality does not have an accounting policy or consistent tariff for consumer deposits of R349 000 that is disclosed in note 4 to the annual financial statements. As these deposits represent less than two percent of the amount due to the municipality, it did not ensure that adequate consumer deposits were obtained before services were supplied to consumers. Furthermore the amount reflected in the supporting register provided differed by R62 000 to the amount disclosed in note 4. Reconciliation of the balance disclosed in the general ledger could not be provided and there were no alternative procedures that could be performed to verify this balance. As a result, it was not possible to obtain sufficient evidence relating to the completeness and valuation of consumer deposits.

Unspent conditional grants and receipts

13. Unspent conditional grants and receipts of R5.7 million are disclosed in note 5 to the annual financial statements. Included in this balance is R3.7 million relating to the Municipal Infrastructure Grant (MIG). Unexplained differences totalling R2 million were found in the grants register provided in support of MIG funding. Furthermore, an unreconciled difference of R1.7 million existed between the project expenditure listing provided and the relevant general ledger accounts for projects funded through the MIG conditional grant.
14. Contrary to section 123 of the MFMA, note 3 to the annual financial statements did not disclose how the allocations received by the municipality from national and provincial government have been spent. There is also no disclosure on whether the conditions of the allocations received have been met by the municipality.
15. As a result of the above, it was not possible, even through the use of alternative procedures, to confirm that all unspent grants were recorded in the financial records and that they were disclosed at the correct amount.

Commitments

16. No capital commitments are disclosed in note 25 to the annual financial statements. As a tender register or complete tender documentation could not be provided, it was not possible to use this information to perform an alternative audit procedure to

measure capital commitments that may exist. It is however unlikely, given the capital projects that are in progress, that the municipality has no disclosable commitments.

Leases

17. Finance leases of R458 000 were disclosed in note 2 to the annual financial statements. Documentation such as a register of leases, a schedule of lease agreements and individual lease agreements could not be provided during the audit. It was consequently not possible to, even through alternative procedures, confirm that the amount of R458 000 that is disclosed in note 2 of the statement of financial position is complete, classified correctly and correctly disclosed.
18. Finance leases amounting to R439 000 were not disclosed as finance leases in note 2, but were regarded as operating leases. These leased assets were also not capitalised as required by GRAP 13. Leases in note 2 and Property, plant and equipment of R51.5 million that is disclosed in the statement of financial position were thus understated by R439 000.

Accumulated surplus

19. An accumulated surplus of R85.9 million is disclosed in the statement of financial position and the statement of changes in net assets. Documentation or explanations supporting adjustments to the surplus of R37.7 million were not provided. It was thus not possible to confirm the correctness of these adjustments and as a consequence assurance in respect of the accumulated surplus could not be obtained to ensure that all transactions were recorded, they were recorded in the correct account, transactions took place and that they related to the business of the municipality and are correctly disclosed.

Revenue

20. Included in note 10 of the annual financial statements are service charges of R5.6 million. Meter readings or records relating to estimates used in billing customers for service charges were not provided during the audit. A reconciliation of rateable property listed in the valuation roll to assessment rates has not been performed by the municipality. Although a valuation of rateable property was performed during the year under review, it was only finalised and implemented in the 2009-10 financial year. The last valuation of properties conducted in the municipal area before this was performed in 1991 and was thus outdated. This restricted the scope of audit work that could be performed.
21. Journals to the value of R14.6 million were processed without adequate supporting documentation. Furthermore, evidence of the implementation of the indigent policy and the existence of indigent consumers could not be provided. It was, in these circumstances, not possible to perform alternative procedures to confirm that amounts charged to residents for services provided were correct, recorded in the correct account and that such consumers were charged at the applicable rate.
22. Interest on arrears of R1 million is disclosed in the statement of financial performance. Errors of R530 000 were identified in the application of applicable interest rates as well as the related interest calculations applied on outstanding

accounts. Furthermore, contrary to paragraph 29 of GRAP 9, interest on long outstanding consumer debtor accounts was raised. Reliable evidence relating to the municipality's ability to recover interest charged on long outstanding consumer debtors could not be provided. It was thus not possible to confirm that interest on arrear account that is disclosed in the statement of financial performance is all recorded, and that they were recorded in the correct account.

23. According to note 11 of the annual financial statements, government grants and subsidies that were provided to the municipality amounted to R28.3 million. Reconciliations and explanations for income that was received in terms of the Division of Revenue Act (Act 2 of 2008) (DoRA) and grant funds, during the year were not provided during the audit. Furthermore, there was a lack of information in the general ledger regarding funds received. In these circumstances, it was not possible to confirm that all transactions were recorded, they were recorded in the correct account, transactions took place and that they related to the business of the municipality and that they were recorded in the correct period.

Expenditure

24. Purchases of R20.6 million in respect of general expenses, grants and subsidies, contracted services and bulk payments was disclosed in the statement of financial performance. The municipality did not provide payment vouchers and source documentation for R3.4 million of these purchases. Furthermore, expenditure totalling R9.7 million that was disclosed as current expenditure should have been recognised as capital expenditure. It was consequently not possible, to perform alternative procedures or in any way confirm that the expenditure of R20.6 million that is disclosed in the statement of financial performance did take place, is accurate, complete, recorded in the correct account and is correctly disclosed.

Irregular expenditure

25. The municipality did not disclose irregular expenditure of at least R13.7 million in the annual financial statements. This irregular expenditure was incurred as a result of procurement processes that were not properly followed as well as irregular salary and overtime payments.

Employee costs and remuneration of councillors

26. Employee costs of R12.4 million is disclosed in note 12 to the annual financial statements. No reconciliation between the payroll system of the municipality and its general ledger system could be provided. Additional audit procedures to reconcile the respective balances of these systems were not successful. Journals in respect of employee cost amounting to R14.6 million were also processed without adequate supporting documentation. As a result it was not possible to confirm that all transactions were recorded, they were recorded in the correct account, took place and that they related to the business of the municipality and that they recorded in the correct period.

Financial instruments

27. The municipality did not to comply with the provisions of the International Accounting Standards (IAS) 32 and 39 in respect of the disclosure, recognition and measurement of financial instruments. Due to a lack of documentation it was not possible to assess the impact of this non-disclosure on the financial statements. Furthermore, the municipality did not disclose any items required by the International Financial Reporting Standard (IFRS) 7, either in the statement of financial position or in the notes to the annual financial statements.

Disclaimer of opinion

28. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

I draw attention to the following matter on which I do not express a disclaimer of opinion:

Unauthorised expenditure

29. Disclosed in note 23.1 to the annual financial statements is unauthorised expenditure of R13.4 million that was incurred as sufficient monitoring did not take place to ensure that actual expenditure exceeded the approved budget.

Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

30. The supplementary information set out on pages 32 to 35 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

MFMA

31. Contrary to section 79 the accounting officer did not develop an appropriate system of delegation of responsibilities to strengthen operational efficiency as delegation of powers was only approved at the end of the financial year on 5th of July 2009.

Governance framework

32. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

33. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
8	Cash and cash equivalents			3		
9 & 11	Trade and other receivables			3		
10	Trade and other receivables - Journals	5				
12	Trade and other receivables - Doubtful debts	7				
13	Revenue	5		3		
14	Interest on arrears	5				
16	DoRA reconciliations	5				
17	VAT	7		3		
18	PPE and investment properties	7		6		
19	PPE – Journals	5				
20	Trade payables	5				
21	Consumer deposits			3		
22	Unspent conditional grants and receipts	5		3		
23	Unspent conditional grants and receipts	7				
25	Commitments	7		6		
26	Leases	7		3		
27	Accumulated surplus	7		5		
29	Expenditure	5		3		
30	Expenditure – classification	7		5		
31	Irregular expenditure	7		3		

32	Employee related costs			3		
33	Employee related costs – Journals	5				

Control environment

34. Management did not establish and maintain an environment throughout the municipality that was supportive of internal control and conscientious management. The failure to create a stable control environment through the adoption of approved policy and procedure frameworks contributed largely towards the same matters that were reported in the previous financial year, being reported on again. Furthermore there was a lack of review and reconciliations to ensure competent and error free reporting.
35. The non-submission of documentation and information was continuously brought to the attention of management. This was mainly due to deficiencies that existed in the filing and archiving system.
36. Staff in the municipality's operational sections generally lacks appropriate skills and as a collective the municipality has not undergone the minimum pre-requisite training.

Control activities

37. Manual or automated controls were often not found in the municipality's systems. These deficiencies were also not addressed even though they often have been raised in prior audit reports. Policy and procedures frameworks have not been created and implemented for all major accounting cycles.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7

Key governance responsibilities

38. MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is

the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		✓
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.		✓
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		✓
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.	✓	
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.		✓

Development and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		
	<ul style="list-style-type: none"> The municipality had an audit committee in operation throughout the financial year. 		✓
	<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 		✓
	<ul style="list-style-type: none"> The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 		✓
7.	Internal audit		
	<ul style="list-style-type: none"> The municipality had an internal audit function in operation throughout the financial year. 		✓
	<ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. 		✓
	<ul style="list-style-type: none"> The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. 		✓
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		✓
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		✓

10.	The information systems were appropriate to facilitate the preparation of the financial statements.		✓
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(c)(i) of the MFMA.		✓
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.		✓
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.		✓
14.	Oversight resolutions have been substantially implemented.	N/A	
Issues relating to the reporting of performance information			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		✓
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		✓
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the municipality against its mandate, predetermined objectives, outputs, indicators and targets section 68/87 of the MFMA.		✓
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		✓

39. The control environment in the municipality is not conducive to sound governance and accountability as the leadership has not ensured that the control environment has received the appropriate attention. The following key governance responsibilities have not been effectively addressed:

- Not all information was presented for audit purposes and management also did not present a copy of the annual report prior to the issue of the audit report. Senior management was also not at the municipality to readily available to respond to audit queries.
- There is a lack of monitoring over financial accounting processes. This resulted in material amendments to the financial statements. Financial accounting processes have not been assessed and adjusted to ensure that all processes support the information requirements of the GRAP framework.
- A complete risk assessment to supplement a risk management strategy was not conducted for the financial year under review. A fraud prevention plan has also not been implemented.
- The internal audit section has not been created or staffed.
- The municipality makes use of a shared audit committee. The absence of an internal audit section and a risk assessment resulted in the audit committee not being effective.

- The significant deficiencies in the design and implementation of internal control in respect of the financial, risk assessment and compliance with applicable laws and regulations areas were attributed to a lack of implemented controls and a lack of monitoring and supervision by management.
- As is evident from the findings in this report the accounting record system of the municipality was not in all respects adequate to allow for the preparation of the annual financial statements.
- Management has not taken sufficient action to clear all prior year audit findings. There was no audit intervention plan and certain matters in the management report as well as this report were also raised in prior financial years.
- No systems are in place to ensure that non-financial performance is measured and reported on.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

40. I was engaged to review the performance information.

The accounting officer's responsibility for the performance information

41. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

The Auditor-General's responsibility

42. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

43. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

44. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Non-compliance with regulatory requirements

Lack of adoption or implementation of a performance management system

45. Section 6 of the MSA requires the municipality to establish, develop and monitor its performance management systems. The municipality did not collect, record and

process information or monitor and report on development priorities and objectives for the performance management systems. As a result key performance indicators had not been set for each of the development priorities and objectives as set out in the integrated development plan. Development priorities and objectives of the municipality's integrated development plan are neither consistent with the budget nor clear and concise. Furthermore, these development priorities and objectives are not measurable.

Content of integrated development plan (IDP)

46. The deadline dates set in the IDP for several key performance indicators and targets were exceeded. No revisions of due dates or explanations for not meeting set deadlines were provided.

47. The 2008-09 Service Delivery and Budget Implementation Plan did not include service delivery targets and performance indicators.

48. The following information relating to the IDP was not provided:

- Minutes of IDP steering committee meetings
- Evidence that the local community were given 21 days to comment on the draft IDP
- Minutes of council meetings where the 2008-09 IDP was approved
- Evidence that the public was given notice that IDP was adopted by council
- Evidence that the 2008-09 IDP was submitted to the MEC
- Minutes of all representative forum meetings held during the 2008- 09 financial year

Internal auditing of performance measurements

49. The municipality did not develop and implement mechanisms, systems and processes for the auditing the results of performance measurement as part of its internal audit processes and thus contravened section 45 of the MSA.

Performance information not received

50. An assessment could not be performed of the reliability of the reported performance information, as set out on pages [xx] to [xx] of the annual report, since the information was not received for audit purposes.

APPRECIATION

51. The assistance rendered by the staff of the municipality during the audit is sincerely appreciated.

East London

30 November 2009



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

DRAFT